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Supreme Court, U.S.
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Supreme Court of the United States

October Term, 1971

No. .....

71-403

GOUGH INDUSTRIES, INC., Debtor,

Petitioner,

vs.

DON ROTHMAN (Successor to A. J. Bumb, deceased), Receiver, STATE BOARD OF EQUALIZATION,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

MARTIN GENDEL,
LEONARD G. LEIBOW,
RICHARD F. BROUDE,
6380 Wilshire Boulevard,
Los Angeles, Calif. 90048,
Attorneys for Gough Industries, Inc. Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

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GOUGH INDUSTRIES, INC., Debtor,

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vs.

DON ROTHMAN (Successor to A. J. Bumb, deceased), Receiver, STATE BOARD OF EQUALIZATION,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner Gough Industries, Inc., a corporation, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on June 22, 1971.

Citations to Opinions Below.

The Referee in Bankruptcy's order is unpublished and unreported, but is printed in the Appendix hereto at pages 1 to 12. The District Court entered an order (printed in the Appendix at pages 12 to 13) adopting the Findings of Fact and Conclusions of Law of the Referee in Bankruptcy, and its order denying relief to Petitioner is unreported. The opinion of the Court of Appeals is reported in .... F.2d .... and printed in the Appendix hereto at pages 14 through 29.

Jurisdiction.

The judgment of the Court of Appeals for the Ninth Circuit was entered June 22, 1971. No petition for rehearing was filed. Jurisdiction of this Court is invoked pursuant to 11 U.S.C. §§47c and 716, and 28 U.S.C. §1254(1).

Questions Presented.

1. Is a debtor rehabilitated in proceedings for an arrangement under Chapter XI of the Bankruptcy Act relieved from liability for post-petition penalties and interest arising from state sales and use taxes where its Receiver wilfully delayed paying those taxes?

2. Is a rehabilitated debtor liable for post-petition interest and penalties arising as a result of state use and sales taxes due and owing by the debtor at the time it filed its petition seeking relief under Chapter XI of the Bankruptcy Act?

3. Do state sales and use tax credits, which are non-assignable under state law and which are recognized by the state due to the writeoff of uncollectible accounts receivable by the rehabilitated debtor, vest in the Chapter XI receiver or remain with the rehabilitated debtor?

Statutes Involved.

11 U.S.C. §104a(4) (as it read in 1964):

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be . . .
>
> (4) Taxes legally due and owing by the bankrupt to the United States, or any State or any subdivision thereof: *Provided*, That no order shall be

made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further*, That in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; . . .

11 U.S.C. §93j:

Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

11 U.S.C. §702:

The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent with or in conflict with the provisions of this chapter, apply in proceedings under this chapter. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors," and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 322 of this Act, and the date of adjudication shall be taken to be the date of the filing of the petition under section 321 or 322 of

this Act except where an adjudication had previously been entered.

11 U.S.C. §734:

Not less than twenty-five nor more than forty days after the petition is filed the court shall hold a first meeting of creditors.

11 U.S.C. §737(1):

At such meeting, or at any adjournment thereof the judge or referee shall, after the acceptance of the arrangement—

(1) designate the receiver or trustee, if any, or the debtor or a person specially appointed as disbursing agent to distribute, subject to the control of the court, the consideration, if any, to be deposited by the debtor; and, if a disbursing agent is so appointed, require such person to give bond with a surety to be approved by the court in such amount as the court shall fix, and fix the amount or rate of his compensation, not in excess of the compensation allowable to a receiver serving as a mere custodian under this Act;

(2) fix a time within which the debtor shall deposit, in such place as shall be designated by and subject to the order of the court, the consideration, if any, to be distributed to the creditors, the money necessary to pay all debts which have priority, unless such priority creditors shall have waived their claims or such deposit or consented in writing to any provision of the arrangement for otherwise dealing with such claims, and the money necessary to pay the costs and expenses of the proceedings; and

(3) fix a time for the filing of the application to confirm the arrangement and for a hearing on the confirmation thereof or any objections to the confirmation, unless such times have already been named in the notice of the meeting or unless all creditors affected by the arrangement have accepted it.

11 U.S.C. §757:

An arrangement made within the meaning of this chapter may include—

(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;

(2) provisions for the rejection of any executory contract;

(3) provisions for specific undertakings of the debtor during any period of extension provided for by the arrangement, including provisions for payments on account;

(4) Provisions for the termination, under specified conditions, of any period of extension provided by the arrangement;

(5) provisions for continuation of the debtor's business with or without supervision or control by a receiver or by a committee of creditors or otherwise;

(6) provisions for payment of debts incurred after the filing of the petition and during the pendency of the arrangement, in priority over the debts affected by such arrangement;

(7) provisions for retention of jurisdiction by the court until provisions of the arrangement, after its confirmation, have been performed; and

(8) any other appropriate provisions not inconsistent with this chapter.

11 U.S.C. §771:

> The confirmation of an arrangement shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, except as provided in the arrangement or the order confirming the arrangement, but excluding such debts as, under section 17 of this Act, are not dischargeable.

Statement of the Case.

These proceedings were commenced on September 14, 1964, by the filing of a petition under §322 of Chapter XI of the Bankruptcy Act (11 U.S.C. §722) by Gough Industries, Inc. ("Gough" or the "Rehabilitated Debtor"), petitioner herein. On November 3, 1964 Gough filed its First Amended Plan of Arrangement and on December 17, 1964, the Referee in Bankruptcy entered his Order Confirming First Amended Plan of Arrangement.

In broad terms, Gough's plan of arrangement provided that it would purchase from its Receiver for cash those assets comprising the inventories and related assets of its supply and lamp division, and that it would thereafter operate that division for its own account. The remaining assets were to be converted into cash and distributed to Gough's creditors in accordance with the First Amended Plan of Arrangement. So far as is here pertinent, the First Amended Plan of Arrangement contained the following provisions regarding taxes:

(1) Article II, paragraph C, in describing classes of creditors, included: "Priority debts are those which fall under the provisions of Sections 64a(2), (4), and (5) of the Bankruptcy Act."

(2) Article III, concerning provisions for the payment of creditors, provided: "Priority debts shall be paid from the cash created through liquidation of assets by the Debtor-in-Possession and Controller, as follows: . . . All tax claims shall be paid in full and in such manner and at such time as may be agreeable to the taxing agencies."

The Order Confirming First Amended Plan of Arrangement provided, in paragraph 4(c) that: "Payment shall then be made to those creditors entitled to priority under §§64(a)(2), (4) and (5) of the Bankruptcy Act." In paragraph 12 it was "Ordered that the Debtor shall be, and hereby is, discharged from all of its dischargeable debts, claims and liabilities, as provided in the Bankruptcy Act. . . ."

On January 8, 1965, (after the Plan had been confirmed) the California State Board of Equalization (the "Board") filed its Proof of Priority Claim for $86,769.88. Of this amount, $85,978.95 was for sales and use taxes incurred prior to September 14, 1964, and $790.93 was interest to that date. On July 21, 1966, the Board filed an "Amended Claim, Proof of Priority Claim" for taxes, reflecting a sum due from Gough of $24,503.19, assessed under the provisions of the California Sales and Use Tax Law. This sum was comprised of $23,712.26 tax and $790.93 interest. The statement of account attached to the Proof of Claim reflected (1) a credit of $3,945.24; (2) payment in the amount of $58,321.45 made May 25, 1966 by A. J. Bumb, Receiver (more than 17 months after the initial Proof of

Claim had been filed); (3) "adjustments" for "interest back to 9-14-64,—8,148.94"; and (4) Penalty omitted from claim,—$16,521.60." The credit of $3,945.24 was allowed because $98,631 in bad debts had been "written off for income tax purposes as of 6-30-65. . . ." On or about December 1, 1966, a Statement of Account, dated November 25, 1966, was forwarded by the Board to the Rehabilitated Debtor. This statement indicated that no tax was due, but claimed that there was due and owing the sum of $25,263.38, comprised of $8,741.78 interest which had accrued from and after September 14, 1964 (the date of commencement of these proceedings) through May 25, 1966 (the date of payment of $58,321.45 by A. J. Bumb, Receiver); and $16,521.60 penalties. Of this latter amount, $7,-923.70 had accrued prior to September 14, 1964, and $8,597.90 had accrued on February 4, 1965 because the Board's tax claim had not been paid by that date.

On December 15, 1966 the Board issued a notice of credit reflecting a credit in the amount of $24,503.19 with the explanation "credit due for bad debts of $612,-579 written off for income tax purposes as of 6-30-65. . . ." The amount of the credit coincided with the amount of tax stated to be due in the Amended Proof of Claim filed by the Board of July 21, 1966.

Thus, the amounts presently owing the Board, and which it seeks to collect from Gough are:

(1) $8,741.78—post-petition interest
(2) 7,923.70—pre-petition penalities
(3) 8,597.90—post-petition penalties.

At all times after December 17, 1964, the date of the entry of the Order Confirming the First Amended Plan of Arrangement, A. J. Bumb, in his capacity as

controller, receiver or disbursing agent, had funds sufficient to pay the total tax claimed by the Board and any penalities and interest with respect thereto, as well as all other tax claims, as recited in the Order Confirming Amended Plan of Arrangement and by A. J. Bumb in testimony given in a hearing held in the instant proceedings.

On October 19, 1967 Gough sought an order requiring the Chapter XI estate to pay the accrued interest and penalties and to enjoin the Board from attempting to collect any moneys from it. After holding an evidentiary hearing, the Referee denied Gough's application, concluding that the First Amended Plan of Arrangement and the confirmation order did not require the Chapter XI estate to pay the penalties and post-petition interest. He also found that the tax credits in excess of $28,000 which had arisen from bad debts had passed to the Receiver for the creditors' benefit. Finally, the Referee held that: "There was no unreasonable delay in the payment of the tax claim of the Board by A. J. Bumb as Receiver and disbursing agent."

A petition for review was taken from the Referee's order to the United States District Court for the Central District of California, pursuant to 11 U.S.C. §11a-(10) of the Bankruptcy Act and 11 U.S.C. §67c. Upon affirmance of the Referee's order by the District Court an appeal was taken to the United States Court of Appeals for the Ninth Circuit, pursuant to 11 U.S.C. §47a.

ARGUMENT FOR GRANTING WRIT.

I.

The Holding by the Court Below That the Receiver Had Not Delayed for an Unreasonable Period of Time in Paying Taxes Assessed by the State Board of Equalization Conflicts With the Decisions of the Supreme Court in Delineating the Obligations of a Receiver Appointed Under the Bankruptcy Act.

The problem of the liability of a receiver for penalties resulting from failure to perform certain acts or file certain returns during his administration is one which requires clarification by this Court. The matter had been seemingly well settled in *Boteler v. Ingels*, 308 U.S. 57, 60 S.Ct. 29, 84 L.Ed. 78 (1939), where it was held that a trustee in bankruptcy, who failed to pay state automobile license taxes incurred while he was operating the business of the bankrupt estate, was liable for penalties growing out of this failure. Substantial doubt was thrown upon the rationale, if not the holding, of *Boteler* by this Court in *Nicholas v. United States*, 384 U.S. 678, 86 S.Ct. 1674 (1966). In that case a Chapter XI petition was filed by Beachcomber Motel and, during the pendency of the arrangement proceeding, the debtor operated its business as a debtor-in-possession, incurring certain Federal tax liability. Ultimately, the debtor was adjudged a bankrupt and a trustee appointed. Twelve days after his appointment, certain taxes were due to be paid; three months after that, certain other taxes became due and payable. The trustee in bankruptcy neither paid the taxes nor filed any of the returns required with respect thereto. The United States submitted an administrative expense claim for the principal of the taxes, penalties assessed

by reason of the trustee's failure to file returns, and accumulated interest. This Court held that the trustee was liable for the penalties for failure to file the return, stating:

> ". . . It is conceded that the trustee, in his status as representative of the bankrupt estate and successor in interest to the debtor in possession, is liable for the principal of the taxes incurred by the debtor in possession, to the extent of the priority enjoyed by the taxes under §64a(1) of the Bankruptcy Act. Once that liability is established, there can be no question that, under §6011(a) of the Internal Revenue Code, the trustee was under an obligation to file returns for these taxes, even though the taxes themselves were incurred by the debtor in possession during the pendency of the arrangement proceeding. It therefore follows under *Boteler* that, in the circumstances of the present case, where a Chapter XI arrangement has been superseded by a liquidating bankruptcy under the Bankruptcy Act, the United States is entitled to exact the penalties here in question as a legitimate means to enforce the prompt filing of the tax returns. Although the rule in *Boteler* may be open to some question as applied to the facts of that case, no such difficulty is presented here. In *Boteler*, the trustee was penalized for his failure actually to *pay* the license fees within the time period prescribed by the State, even though it could not have been clear at that date that the assets of the bankrupt estate would be sufficient to pay all of the expenses of administration that were entitled to share equally with the taxes under the first priority of § 64(a)(1) of the Bankruptcy Act in

> any distribution of assets from the estate. In the present case, on the other hand, the penalties were imposed solely because of the trustee's failure to file timely returns for the taxes incurred during the Chapter XI arrangement period." (384 U.S. at 692-695, 86 S.Ct. at 1684-85).

Unlike *Boteler,* it is conceded that the Receiver in the case at bar at all times relevant hereto had more than sufficient funds to pay the principal of the sales and use taxes, interest to the date of payment, and both pre-petition and post-petition penalties. His failure to act with expedition is the reason that the Board is now asserting that the Rehabilitated Debtor owes $8,741.78 in post-petition interest and $8,597.90 in post-petition penalties. While the result in *Boteler* would indicate that the Receiver was under an obligation to pay taxes so as to prevent the running of interest, the present vitality of that decision is in some doubt because of the way in which it was distinguished by this Court in *Nicholas.* Moreover, unlike a straight bankruptcy proceeding in which a bankrupt corporation generally is liquidated and ceases to exist, the interest and penalties being asserted hereby the Board have been held by the courts below to be payable by the Rehabilitated Debtor.

There is no question but that the Receiver could have paid the taxes and then instituted appropriate procedures for obtaining a refund of those taxes under California Revenue and Taxation Code §§6901, *et seq.* The Receiver contended for the first time on review and appeal that taxes were not paid because he was attempting to determine the credits for bad debts which would be used as an offset and for other reasons which he contended were inherent in bankruptcy proceedings.

The obligations of a Chapter XI Receiver need clarification and elucidation by this Court. Are receivers going to be permitted to dally and, at such time as it finally suits their convenience, then to decide to pay taxes that are due and owing by the debtor's estate? Or, will this Court now delineate those obligations which must in all cases be performed by receivers where there are funds on hand sufficient to pay priority claims and where there is no question but that those claims will ultimately be paid in full? Indeed, it is a prerequisite to confirmation of a Chapter XI plan for the debtor to have made a deposit sufficient in amount to pay expenses of administration and priority claims, 11 U.S.C. §§771, 772. The Receiver in this case did not do so, not to his detriment but to the detriment of the Rehabilitated Debtor. Certainly the Chapter XI estate, rather than the Rehabilitated Debtor, should be liable for the post-petition interest and penalties incurred as a result of the Receiver's dilatory tactics. However, without guidance from this Court, it is doubtful that receivers will change their methods of operation and take steps necessary to encumber rehabilitated debtors with as little impediment as possible to their ability to make a fresh start.

From a receiver's point of view also, it is apparent that receivers need guidance from this Court regarding their obligations to the estate which they are in part administering. Are they to assume that *Boteler v. Ingels* no longer has its old vitality in light of the comments made about it in *Nicholas?* Are they to withhold payment of taxes, whether or not resulting from their operation of a debtor's business, until such time as it becomes apparent that they will have enough funds to pay all priority claims? These questions should be answered by this Court.

For these reasons, if not for those which follow in this Petition, this Court should grant certiorari, at least with respect to the question of post-petition interest and penalties.

II.

Gough Should Not Be Held Liable for Post-Petition Interest and Penalties Arising From Sales and Use Taxes Which It Owed at the Time That the Chapter XI Petition Was Filed.

A. Post-Petition Interest Is Not Properly Assertable Against a Rehabilitated Debtor Where Taxes Have Been Paid in Full.

A conflict exists between the United States Court of Appeals for the Second Circuit, speaking in *In re Johnson Electrical Corporation*, 442 F.2d 281 (2nd Cir. 1971) and the United States District Court for the Eastern District of Kentucky, speaking in *In re Vaughan*, 292 F.Supp. 731 (E.D.Ky. 1968). Each of these cases sought to interpret the decision of this Court in *Bruning v. United States*, 376 U.S. 358, 84 S.Ct. 906, 11 L.Ed. 2d 772 (1964). *Bruning* held that a discharged bankrupt was properly held liable for the collection of post-petition interest where taxes had not been paid in full during the bankruptcy proceeding. *In re Johnson, supra* (and *Hugh H. Eby Co. v. United States*, 319 F.Supp. 942 (E.D. Pa. 1970)) held that post-petition interest was properly collectible where the entire tax, including pre-petition interest, was paid as a result of a Chapter XI proceeding. *In re Vaughan, supra*, reached the directly contrary conclusion.

Due to the conflicting interpretations by the lower federal courts with respect to the proper reach of the

Bruning decision where, as here, pre-petition taxes have been paid in full, certiorari should be granted by this Court.

B. The Court of Appeals for the Ninth Circuit Improperly Interpreted the Rehabilitated Debtor's Plan of Arrangement in Holding That Gough Was Liable for Post-Petition Interest and Pre- and Post-Petition Penalties.

In the statement of the case set out above, it is to be noted that there is seemingly a contradiction and inconsistency in both the plan of arrangement itself and in the Order confirming the plan. The plan provided, in Article III, that "priority debts shall be paid from the cash created through liquidation of the assets by the debtor-in-possession and controller" and then went on to provide that "*All tax claims* shall be paid in full and in such manner and at such times as may be agreeable to the taxing agencies" (emphasis supplied). The Order confirming the plan provided that "Payment shall then be made to those creditors entitled to priority under Sections 64a(2); (4) and (5) of the Bankruptcy Act." It then went on to provide that it was "Ordered, that the debtor shall be, and hereby is, discharged from all of its dischargeable debts, claims and liabilities, as provided in the Bankruptcy Act."

With regard to paragraph 12 of the Order, one of the attorneys for the Rehabilitated Debtor testified that the plan as originally presented to the court omitted the word "dischargeable" from its provisions and that it originally contemplated the discharge of the debtor from all of its debts. He went on to testify that the word

"dischargeable" was inserted at behest of the Referee who saw no reason for discharging a debtor from debts created by its fraud. Thus, the word "dischargeable" was inserted solely to provide for the non-dischargeability of those possible debts (of which there were none) of the Debtor which had been created through its fraud or other, similar, conduct.

In interpreting the plan and the order, the courts below have consistently refused to give any credence whatever to the testimony of the Debtor's lawyer, and have instead treated the case as one simply of contractual interpretation. This is hardly the way in which to treat a plan of arrangement which contemplates the rehabilitation of a Chapter XI debtor and has as its goal a new and hopefully successful operation by a debtor unencumbered by its pre-Chapter XI debt structure. The cavalier fashion in which the court below treated the Debtor's argument regarding interpretation of its plan is one which calls for rectification by this Court. The court below should be instructed by this Court to interpret plans of arrangement in such a way as to give maximum benefit to the Rehabilitated Debtor so long as the words used can logically be held to lead to such a result. There is no reason to hold the Debtor liable for the interest and penalties claimed by the Board under the circumstances presented by this case, without compelling reasons, particularly in light of the fact that the Receiver at all times had funds sufficient to pay that interest and those penalties in full. This Court, in the exercise of its supervisory powers over the courts of the Federal system, should instruct the Court of Appeals for the Ninth Circuit regarding the proper goals to be kept in mind and the proper considerations to be used in interpreting Chapter XI plans and orders confirming those plans.

III.

State Sales and Use Tax Credits, Which Are Non-Assignable Under State Law and Which Were Recognized by the State Due to the Writeoff of Uncollectible Accounts Receivable by the Rehabilitated Debtor, Did Not Vest in the Chapter XI Receiver but Remained With the Rehabilitated Debtor.

As indicated in the Statement of the Case, the Board on July 11, 1966, and on December 15, 1966, allowed credits in the amounts of $3,945.24 and $24,503.19, respectively, totaling $28,448.43. These credits were based upon bad debts written off by the Rehabilitated Debtor for income tax purposes as of June 30, 1965. These credits did not come into existence until they were granted by the Board on July 11, 1966, and December 15, 1966, respectively. The act of the Board alone established these credits some two years after the filing of the Chapter XI Petition. Certainly, these credits could not have been in existence at any time prior to June 30, 1965, the date as of which they were written off as bad debts by the Rehabilitated Debtor. Admittedly, the bad debts arose in part from uncollectible accounts which passed to the Receiver as having been earned by the Debtor during the operation of its pre-Petition business. However, on September 14, 1964, the right to a sales tax credit was not yet a right in expectancy because at that point there was no assurance that the receivables would in fact be uncollectible or collectible in whole or in part or that the bad debts would be allowed for income tax purposes as well as for sales and use tax purposes.

The issue, therefore, is whether the Receiver was entitled to the use of such credits for the purposes of the

estate or whether, as a matter of law, such post-Petition credits belonged to the Rehabilitated Debtor.

Although speaking to the carry*forward* of net operating losses vis-a-vis net operating loss carry*backs,* the conceptual problem of applying post-Petition tax benefits to the estate is explained in 4A *Collier on Bankruptcy* (14th Ed.), par. 70.28 [4.1] at 405, as follows:

> "The loss-carryforward does not give rise to a claim for refund or a right against a fund in and of itself, while the loss-carryback does give rise to a specific refund claim. . . . In the case of corporate bankrupts, the entity may well be one and the same, that is, the corporation and the bankrupt estate, in which the trustee should be able to utilize whatever rights his alter-ego, the corporation has. But, it has been argued, if the corporation obtains a discharge and remains in business, two entities now exist, the estate and the continuation of the corporation which would require that the corporation retain the right of loss-carryforward. That the situation is complex and unanswered is an understatement."

As indicated in the quote, there is little authority concerning the issue. The issue in the case of *In re Goodson,* 208 F.Supp. 837 (S.D.Cal. 1962), concerned whether the trustee or the bankrupt had a right to an income tax refund (due to excess withholding) arising for the year (1960) in which the bankrupt filed his petition. The petition was filed on November 30, 1960. The refund for the year was $282.39, allocated $233.55 for pre-petition withholding and $48.44 for post-petition withholding. The Referee concluded that the trustee was entitled to $233.55 and the Debtor to $48.44. The

Debtor petitioned for review of the award to the Trustee. The District Court, after a lengthy analysis of the problem, affirmed the Referee.

If nothing else, *Goodson* recognizes that post-petition tax benefits arising from events transpiring after the filing of the petition belong to the Debtor and not to the estate. Such benefits can hardly be property passing to the estate if they do not exist even in expectancy at the date of the filing of the petition. The Order Confirming Amended Plan of Arrangement was entered by the Referee on December 17, 1964, and, as stated in *Collier, supra,* "if the corporation obtains a discharge and remains in business, two entities now exist, the estate and the continuation of the corporation. . . ." It was to the Rehabilitated Debtor and not to the estate that the credits were issued, based on events occurring after the date of the filing of the petition. Petitioner submits, therefore, that the Receiver was incorrectly permitted to use the credits against a tax which under the Plan was the sole liability of the estate. It follows that such credits should be restored to the Rehabilitated Debtor and the estate should be directed to pay the penalties and interest now asserted to the extent of the credits which the estate used.

The Referee below, in his Conclusion of Law VI, in determining that the credits were assets of the Debtor estate at the date of bankruptcy, relied on *Segal v. Rochelle,* 382 U.S. 375, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966). Such reliance was unwarranted, since the facts in *Segal* deal with an income tax loss carryback. While it is difficult to fit the instant credits into the concept of an income tax carryback *or* carryforward; if analogous to anything the subject credits are logically analogous to a carryforward. In this connection, it should

be noted that the Court in *Segal* expressly declined to involve itself with this point, indicating as follows:

> "Without ruling in any way on a question not before us, it is enough to say that a carryover into post-bankruptcy years can be distinguished conceptually as well as practically." (382 U.S. at 381.)

Most importantly, this Court in *Segal,* 382 U.S. at 384 and 385, as well as 4A *Collier,* para. 70.28 at 403, indicate that the holding was *not* that the refund claimed was transferable under *all* circumstances, but that the determination whether or not the claim is "property" and therefore "transferable" must be made by reference to State law. Apparently the State law in Texas was such that an assignment of the subject claim would be enforced in the Texas State Courts, notwithstanding the prohibition against such assignments in 31 U.S.C. §203. However, the law in the State of California would require a different result. Section 6937 of the California Revenue and Taxation Code which deals with the matter of suits for refunds and credits in connection with State Sales and Use Taxes, provides as follows:

> "A judgment shall not be rendered in favor of the plaintiff in any action brought against the Board to recover any amount paid when the action is brought by or in the name of an *assignee* of the person paying the amount or by any person other than the person who paid the amount." (Emphasis added).

It would appear to logically follow that if an assignee could not sue for such a credit or refund under California State Law, even assuming *arguendo* that the

rule in *Segal* applied, then the refund or credit, at least in California, could not be "property" which was subject to "transfer". Thus, under §70a(5) of the Bankruptcy Act (11 U.S.C. §110a(5)), the claim for refund did not pass to the Chapter XI estate.

Moreover, all of the courts below have failed to recognize the crucial distinction between *Segal*, even if that case were applicable, and the case at bar. In *Segal* the taxes which were to be refunded had been paid by the bankrupt prior to the institution of bankruptcy proceedings, while in the case at bar the taxes were due and owing *and unpaid* at the time of the filing of the Chapter XI petition by Gough. This case, then, does not involve a refund of taxes, but instead involves a credit against taxes claimed to be due and owing and in which the events which give rise to the offset did not occur until after the commencement of proceedings under the Bankruptcy Act. The Court of Appeals for the Ninth Circuit refused to draw a distinction between the two situations, holding that the accounts receivable passed to the Receiver, and since those accounts were ultimately deemed uncollectible, it was those accounts which gave rise to the tax credits. This analysis fails for two reasons: (1) as indicated above, the uncollectibility of the accounts was a post-petition event; and (2), more importantly, there exists a meaningful distinction between a refund of taxes already paid and credits against taxes unpaid. This Court has never addressed itself to the latter problem and the question calls for an answer. In almost every Chapter XI case a debtor files a petition owing a substantial amount of taxes. While pre-petition losses might very well be analogous to the facts which gave rise to the result in *Segal*, the same should not be true with respect

to credits or offsets which arise out of events and determinations which are made only after institution of the proceedings. It would be of significant benefit to the administration of estates under Chapter XI were this Court to resolve the question of applicability of *Segal* to situations in which taxes had not been paid prior to the institution of bankruptcy proceedings.

Independently of this Court's approach in *Segal*, the loss carryback analogy fails because it attempts to compare incomparables. Under §172 of the Internal Revenue Code, the application of the operating loss is fixed—three years back and five years forward. The application cannot be varied. Assuming correct timing, a trustee or receiver is entitled to apply the carryback because by statute he must reach back to a pre-bankruptcy year and "property" belonging to that period belongs to the trustee or receiver. However, California Revenue and Taxation Code §6901 provides: "if approved by the State Board of Control the excess amount collected or paid shall be credited *on any amounts then due and payable* from the person from whom the excess amount was collected. . . ." (Emphasis supplied). Had the Rehabilitated Debtor owed sales taxes, income taxes or, indeed, any taxes which accrued after September 14, 1964, the Board could have applied the credit to those taxes. Thus, the Receiver in this case was not automatically entitled to the benefit of the credit. It is inconceivable that the law would penalize the Rehabilitated Debtor for timely payment of its post-September 14, 1964 taxes. Had the Rehabilitated Debtor been delinquent on any post-September 14, 1964 taxes incurred by it, the Board could have applied the credit to eliminate those deficiencies. The Receiver would have been left in the same position he

originally occupied—he would have been required to pay the taxes he was ordered to pay under the confirmed Plan. The result reached by the courts below, however, works a penalty on the honest Rehabilitated Debtor, which was diligent in the payment of its obligations because the Receiver now claims the benefit of the credit which was clearly not property and which could not have vested in the Receiver.

Conclusion.

This is a case which raises issues of substantial importance to the administration of estates of Chapter XI debtors. Implicit throughout the case are the countervailing forces of the ability of taxing authorities to collect taxes, interest and penalties on the one hand, and, on the other, the fundamental policy of bankruptcy administration to allow post-bankruptcy bankrupts and debtors to make a fresh start. To the extent to which the policies adopted by the courts below are permitted to go unchallenged, that is the extent to which the policy of the Bankruptcy Act will be frustrated.

In addition, it has become apparent that guidance from this Court is necessary if receivers and trustees are to perform their duties with expedition and efficiency. The effect of the decision below is to give receivers unencumbered discretion to engage in dilatory tactics to the detriment of the debtor whose rehabilitation is supposed to be among their goals. For these reasons, we respectfully submit, this Court should grant a writ of certiorari.

MARTIN GENDEL,
LEONARD G. LEIBOW,
RICHARD F. BROUDE,
Attorneys for Gough Industries, Inc. Petitioner.

APPENDIX.

A. Findings of Fact and Conclusions of Law (Sales Tax Claim of Debtor) and Order Thereon Entered by Referee Russell B. Seymour on October 11, 1968.

United States District Court, Central District of California.

In the Matter of Gough Industries, Inc., a California corporation, Debtor.

In Proceedings Under Chapter XI, No. 177,485-TC.

This matter having come on for hearing on the "APPLICATION by (reorganized) GOUGH INDUSTRIES, INC., re: STATE BOARD OF EQUALIZATION" on February 26, 1968 at the hour of 2:00 p.m. thereof and having been continued, successively, as follows: to April 19, 1968 at the hour of 10 a.m. thereof, to May 9, 1968 at the hour of 2:00 p.m. thereof, to June 4, 1968 at the hour of 2:00 p.m. thereof, to June 24, 1968 at the hour of 2:00 p.m. thereof; and the Debtor having appeared by and been represented through its counsel, GENDEL, RASKOFF, SHAPIRO & QUITTNER by LEONARD LIEBOW, and the Respondent CALIFORNIA STATE BOARD OF EQUALIZATION having appeared by and been represented through its counsel THOMAS C. LYNCH, Attorney General by NEIL J. GOBAR, Deputy Attorney General, and Respondent A. J. BUMB, the Receiver herein, having appeared by and been represented through his counsel, C. E. H. McDONNELL; and evidence both all and documentary having been offered and received, and the Referee being fully advised in the premises, does now make his Findings of Fact and Conclusions of Law based thereon:

FINDINGS OF FACT

I

On September 14, 1964 GOUGH INDUSTRIES INC., the Debtor, commenced the above-captioned proceedings by the filing of the petition under Section 322 of Chapter XI of the Bankruptcy Act.

II

On October 23, 1964 GOUGH INDUSTRIES INC., the Debtor, filed a proposed Plan of Arrangement in the said Chapter XI proceedings.

III

On November 3, 1964 the Debtor filed its proposed FIRST AMENDED PLAN OF ARRANGEMENT in the said Chapter XI proceedings.

IV

On December 17, 1964 the *Court made an Order confirming* the *FIRST AMENDED PLAN OF ARRANGEMENT*. At the time of the entry of said Order, the deposit required by the Bankruptcy Act in an amount sufficient to *pay all priority debts, including all tax claims, including interest and penalties,* if any, had been deposited with A. J. Bumb, Controller.

V

That the FIRST AMENDED PLAN OF ARRANGEMENT proposed in part as follows:

"C. Priority debts are those that fall under the provisions of Sections 64a (2), (4), and (5) of the Bankruptcy Act.

* * *

"B. From the cash created through the liquidation of assets by the Debtor in possession and Controller,

priority debts shall be paid from the cash created through liquidation of assets by the debtor in possession and Controller as follows: All labor claims entitled to priority shall be paid as soon as monies are available for that purpose without awaiting formal confirmation of the Plan of Arrangement. All tax claims shall be paid in full and in such manner and at such time as may be agreeable to the taxing agencies."

VI

That the Order confirming the FIRST AMENDED PLAN OF ARRANGEMENT provided in part as follows:

"3. ORDERED that those certain assets of the Debtor Corporation provided for in the FIRST AMENDED PLAN OF ARRANGEMENT are hereby revested in said Debtor forthwith, and the Debtor forthwith shall be entitled to manage its affairs free and clear of any claims, liens or liabilities whatsoever, which are dischargeable, * * *

* * *

"12. ORDERED that the Debtor shall be, and it hereby is, discharged from all of its dischargeable debts, claims and liabilities as provided in the Bankruptcy Act; * * *".

VII

The *provisions of the FIRST AMENDED PLAN OF ARRANGEMENT* and the Order *of this Court confirming that Plan of Arrangement contained no provision that all creditors would be paid in full.* The assets *available for distribution by said A. J. Bumb were and are insufficient to pay all creditors in full. The general unsecured creditors with claims prov-*

able and allowed will not be paid in full. The Plan confirmed in this matter is a settlement or satisfaction and not an extension (§ 306 (1) of the Bankruptcy Act).

VIII

That Order of Confirmation did not intend to nor did it provide that GOUGH be relieved of any non-dischargeable liabilities or that the funds *being administered by A. J. Bumb be used to pay any amounts of post-bankruptcy interest or penalties or pre-bankruptcy tax liabilities,* or to pay any other amounts not allowable as claims in straight Bankruptcy proceedings; or in a settlement or satisfaction under Chapter XI; and the said Order of Confirmation did not contemplate and did not provide that the phrase 'discharged from all its dischargeable debts, claims, and liabilities as provided in the Bankruptcy Act; . . .' included or should include any debt which was nondischargeable, whether by reason of fraud or otherwise.

IX

All notices regarding hearings in connection with arrangement proceedings were duly given to all creditors and other interested parties, including the Board. Other than above stated, no notice was given to the Board of any intention on the part of GOUGH to be discharged from the penalties or post-bankruptcy interest or penalties involved herein, until long after the Order of Confirmation had become final.

X

That on January 6, 1965 the *CALIFORNIA STATE BOARD OF EQUALIZATION* (hereinafter referred to as "the Board") *filed its* claim in the GOUGH Chapter XI proceedings in the amount of *$86,769.88;*

that the said claim was thereafter amended by the filing of another claim on July 19, 1966 by the Board; *that the claim filed by the Board was for sales and use taxes claimed to be owing by the Board up to September 14, 1964, the date of the commencement of* the Chapter *XI proceedings and did not claim any penalties or interest after September 14, 1964.*

XI

The Board's claim filed on January 6, 1965, for its own purposes and calculations, *referred to penalties in the amount of $7,923.70 and post-bankruptcy interest in the amount* of $994.04, the amounts of which *were not included in the sum sought in the arrangement* proceedings, $86,769.88. *The amount sought, $86,769.88,* was the *only amount properly allowable in bankruptcy or in this* type of arrangement, even though the claim referred to items totaling $95,687.62.

XII

On May 25, 1966 A. J. Bumb, as Receiver in the above-captioned proceedings and as the disbursing agent under the confirmed FIRST AMENDED PLAN OF ARRANGEMENT *paid to the Board on its tax claim the sum of $58,321.45.*

XIII

A. J. Bumb, as Receiver and disbursing agent caused to be filed with the Board a *request for the allowance of certain debt credits which would result in a credit against the Board's claim of $28,448.43.* The Board thereafter reduced its filed claim in the bankruptcy proceedings by that amount. The credit of $28,448.43 for bad debts was founded upon certain pre-bankruptcy credit sales which became worthless for income tax purposes. The bad debts were the property of the

estate of the debtor at the date of bankruptcy and under the Plan of Arrangement as confirmed they were retained by the Receiver for the benefit of creditors, and they did not revest in the debtor.

XIV

NOTICES OF CREDIT dated July 11, 1966 and December 15, 1966 the Board *granted the credits requested in the sum of $28,448.43 and reduced its filed claim by that amount.*

XV.

That on December 1, 1966 the *Board notified the Debtor,* GOUGH, that the Debtor was *indebted to the Board in the sum of $25,263.38, composed of the following factors (1) interest from* September 14, 1964 in the sum of *$8,741.78;* (2) *Penalties* in the amount of *$16,521.60.* A portion, $8,597.90, of said penalties totaling $16,521.60 had become due on February 4, 1965, because the entire sum of $95,687.62 referred to in Finding XI had not been paid on February 4, 1965. *The interest claimed in the sum of $8,741.78 was interest accrued from after September 14, 1964,* until the payment by A. J. Bumb on May 25, 1966.

XVI

Following applications of payments made by the Receiver to the Board, there remained unpaid the following indebtednesses;

Pre-bankruptcy penalties in the amount of	$ 7,923.70
Post-bankruptcy penalities in the amount of	8,597.90
Post-bankruptcy interest in the amount of	8,741.78
Total	$25,263.38

No part thereof has been paid. The foregoing is without prejudice to any prorated deduction by reason of the credit of $28,448.43 referred to in Finding XIII, which may be proper in a proceeding between the Board and GOUGH INDUSTRIES, INC. Furthermore it is believed this Court has no authority to determine the amount of a non-provable claim other than as may be required by the matter before it. In this context *it is not intended to fix an axact* or *any sum as between GOUGH and the Board, particularly insofar as* the amount of non-provable or nondischargeable interest or penalties may be affected by the credits totaling $25,263.38.

XVII

The Board did not at any time prior to the "Statement of Account" on December 1, 1966 have any Notice of the claim by the Debtor that the liability for any penalties or for any interest on taxes due prior to September 14, 1964 was the responsibility of the Debtor estate and not of GOUGH INDUSTRIES, INC.

XVIII

The CALIFORNIA STATE BOARD OF EQUALIZATION has done nothing to mislead or in any way prejudice the Debtor in connection with this matter. The Debtor did not rely reasonably or at all upon any claim, billing or other acton or statement of the Board to its detriment. No statement, action or representation of the Board damaged or adversely effected the Debtor financially or otherwise. The debtor proved no facts upon which any estoppel against the Board may be based. The Board in no way waived any of its rights against the Debtor, nor did the Board at any time or in any manner elect to seek the amounts herein issue from any source other than the Debtor.

XIX

A. J. Bumb, as Receiver, paid other tax claims from funds in his possession, as he was obligated to do under the Order confirming Plan of Arrangement, as follows: (1) Claim #100 of the Internal Revenue Service in the amount of $16,311.71; (2) Claim #296 of the Internal Revenue Service in the amount of $321.90; (3) Claim #119 of the Department of Employment of the State of California in the amount of $5,764.56. Said claims were paid by A. J. Bumb on or about November 10, 1965, and each claim was paid in the same amount as filed by the taxing authorities.

The failure of the Receiver to earlier make payment to the Board in part was due to desire to require an allowance by the Board of the credit for bad debts and to verify the claim submitted by the Board. The Court finds that the delay in payment arose out of a business judgment reasonably exercised by the Receiver.

CONCLUSIONS OF LAW

I

THE FIRST AMENDED PLAN OF ARRANGEMENT and the Order confirming it did not impose upon the Chapter XI estate the liability to pay penalties or post-bankruptcy interest on any tax claims due and owing prior to September 14, 1964.

II

Penalties and post-bankruptcy interest on taxes arising prior *to bankruptcy are nondischargeable debts and not affected* by *the discharge granted in these Chapter XI proceedings.* The Board could not properly set off credit of $25,263.38 against the penalties or the post-bankruptcy interest. Section 68b (11 U.S.C.

108(b)); Section 57j (11 U.S.C. 93(j)); *United States v. Coleman,* (6 Cir.) 344 F. 2d 903, citing *Simonson v. Granquist,* 369 U.S. 38, 40.

III

The FIRST AMENDED PLAN OF ARRANGEMENT as confirmed by Order of this *Court was a composition and not an extention* with the creditors of GOUGH.

IV

There was no unreasonable delay in the payment of the tax claim of the Board by A. J. Bumb as Receiver and disbursing agent.

V

The conduct of the Board in filing its claim granting credits and accepting payment from the Receiver did not constitute an election, waiver or estoppel against the Board in pursuing any claim it may now or hereafter assert against the Debtor' GOUGH INDUSTRIES, INC.

VI

The credit in the amount of $28,448.43 granted by the Board in its notices of credit dated July 11, 1966, and December 15, 1966, was an asset of the Debtor's estate at the date of bankruptcy and was never revested in the Debtor. *Segal v. Rochelle,* 382 U.S. 375 (379-385); 4A Collier (14th Ed.) ¶70.28 (4.1).

VII

There is now due, owing and unpaid from GOUGH INDUSTRIES, INC., (the 'reorganized' debtor) to the State of California (Board of Equalization) the amount of $25,263.38 upon liability incurred under

the Sales and Use Tax Law upon transactions prior to the commencement of these proceedings. The Board should not be enjoined from effecting collection of any amount which may be owing to it by GOUGH INDUSTRIES, INC. *Bruning v. United States,* 376 U.S. 358; *Poly Industries, Inc. v. Mozley,* (9 Cir.) 362 F.2d 453.

VIII

This Court has *no power to restrain the State of* California (Board of Equalization) *from effecting collection of the indebtednesses referred to in Paragraph VII.*

DATED: October 11, 1968.

/s/ Russell B. Seymour
RUSSELL B. SEYMOUR
Referee in Bankruptcy.

Order Disallowing Sales Tax Claims of Gough Industries Inc.

United States District Court Central District of California.

In the Matter of Gough Industries, Inc., a California corporation, Debtor.

In Proceedings Under Chapter XI, No. 177,485-TC.

This matter having come on for hearing on the "Application by (reorganized) GOUGH INDUSTRIES, INC., re: STATE BOARD OF EQUALIZA-

TION" on February 26, 1968 at the hour of 2:00 p.m. thereof and having been continued, successively, as follows: to April 19, 1968 at the hour of 10:00 a.m. thereof, to May 9, 1968 at the hour of 2:00 p.m. thereof, to June 24, 1968 at the hour of 2:00 p.m. thereof; and the Debtor having appeared by and been represented through its counsel, GENDEL RASKOFF, SHAPIRO & QUITTNER by LEONARD LIEBOW, and the Respondent CALIFORNIA STATE BOARD OF EQUALIZATION having appeared by and been represented through its counsel THOMAS C. LYNCH, Attorney General by NEIL J. GOBAR, Deputy Attorney General, and Respondent A. J. BUMB, the Receiver herein, having appeared by and been represented through his counsel, C. E. H. McDONNELL: in evidence both all and documentary having been offered and received, and the Court having made its FINDINGS OF FACT and CONCLUSIONS OF LAW, and the Referee being fully advised in the premises,

NOW, THEREFORE, IT IS ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

1. The Application of GOUGH INDUSTRIES, INC., be and hereby is denied.

2. Neither A. J. Bumb, as Receiver or Disbursing Agent of the Debtor's estate herein, nor the Debtor estate herein, is indebted to the STATE BOARD OF EQUALIZATION (of the State of California) or to

GOUGH INDUSTRIES, INC. (the 'reorganized' debtor herein) for penalties or interest on any sales or use taxes based on transactions arising before the date of the filing of the petition, under Section 322 of the Bankruptcy Act (11 U.S.C. 722), September 14, 1964.

3. The said STATE BOARD OF EQUALIZATION (of the State of California) is not enjoined or restrained from proceeding against GOUGH INDUSTRIES, INC. (the 'reorganized' Debtor herein) to effect collection of all or any penalties or post-bankruptcy interest on any sales or use taxes based on transactions arising before the date of the filing of the petition under Section 322 of the Bankruptcy Act, September 14, 1964.

DATED: October 11, 1968.

/s/ Russell B. Seymour
RUSSELL B. SEYMOUR
Referee In Bankruptcy.

B. Order Denying Petition on Review, Harry C. Westover, United States District Judge, Entered April 30, 1969.

Order Denying Petition on Review.

United States District Court, Central District of California.

In the Matter of Gough Industries, Inc., a California corporation, Debtor.

In Proceedings Under Chapter XI, No. 177,485-HW.

This matter having come on for hearing on the "Petition For Review" on April 14, 1969 at the hour of 10:00 a.m. thereof; and the Petitioner, GOUGH INDUSTRIES, INC., having appeared by and been represented through its attorneys, GENDEL, RAS-

KOFF, SHAPIRO & QUITTNER, by LEONARD G. LIEBOW; and the STATE OF CALIFORNIA having appeared by and been represented through THOMAS C. LYNCH, Attorney General, by NEAL J. GOBAR, Deputy Attorney General; and the Respondent Receiver, A. J. BUMB, having appeared by and been represented through his attorney, C. E. H. McDONNELL; and Memorandums of Points and Authorities having been filed and considered, and argument made, and the Court being fully advised in the premises,

NOW, THEREFORE IT IS ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

1. The Petition of GOUGH INDUSTRIES, INC. for Review of the Referee's Order of October 11, 1968 be, and the same hereby is, denied.

2. The "Findings of Fact and Conclusions of Law (Sales Tax Claim of Debtor)" of the Honorable RUSSELL B. SEYMOUR, Referee in Bankruptcy, made and entered on October 11, 1968 in connection with the Order from which the Petition on Review was taken be, and the same hereby are, adopted.

3. The "Order Disallowing Sales Tax Claims of Gough Industries, Inc." filed October 11, 1968 be, and the same hereby is, affirmed.

DATED: April 25, 1969.

HARRY C. WESTOVER
United States District Judge.

C. Opinion of United States Court of Appeals for the Ninth Circuit, Filed June 22, 1971.

United States Court of Appeals, for the Ninth Circuit.

Gough Industries, Inc. Debtor, Appellant, v. Don Rothman (successor to A. J. Bumb, deceased), Receiver, State Board of Equalization, Appellees.

Appeal From the United States District Court for the Central District of California.

Before: CARTER, HUFSTEDLER, and TRASK, Circuit Judges.

HUFSTEDLER, Circuit Judge:

Gough Industries, Inc., the reorganized debtor, appeals from an order denying its petition to review the referee's disallowance of Gough's claims against the receiver A. J. Bumb[1] and the debtor estate for penalties and interest assessed against Gough for late payment of California sales and use taxes.

This dispute concerns the construction of the plan for arrangement, the receiver's implementation of the plan's provisions, and the proper attribution of certain tax credits granted to the estate. On September 14, 1964, Gough petitioned for a section 322 arrangement under Chapter XI of the Bankruptcy Act. The plan of arrangement, as amended, provided that Gough, a wholesaler of electrical supplies, appliances, and other items, would pay to the receiver the cash value of the

[1] A. J. Bumb died during the pendency of the appeal, and Don Rothman was substituted for appellee Bumb.

Supply and Lamp Division's inventories and related assets and thereafter operate that division for its own account. The remaining assets would be converted into cash and distributed to Gough's creditors in accordance with the arrangement.

The plan of arrangement classified Gough's creditors and defined the classes. Priority debts were defined as "those which fall under the provisions of Sections 64-(a)(2), (4), and (5) of the Bankruptcy Act." Expenses of administration were "those expenses commonly known as Court expenses of administration incurred herein which may be approved, allowed or ordered paid by the Court." The plan further provided that the receiver would pay the costs of administration and priority debts from the fund created by the liquidation of assets. In regard to taxes, the plan provided: "All tax claims shall be paid in full and in such manner and at such time as may be agreeable to the taxing agencies."

On December 17, 1964, the referee confirmed Gough's amended plan, thereby ordering payment to priority creditors, revesting in Gough the assets of the Supply and Lamp Division "free and clear of any claims, liens or liabilities whatsoever, which are dischargeable," and discharging Gough "from all its dischargeable debts, claims and liabilities, as provided in the Bankruptcy Act."

On January 8, 1965, the California State Board of Equalization filed a proof of its priority claim for $86,769.88. This sum included $85,978.95 for prearrange-

ment sales and use taxes and $790.93 in interest accrued prior to the September 14 filing of Gough's Chapter XI petition.

Gough's receiver paid $58,321.45 on this claim on May 25, 1966. Additionally, the receiver obtained tax credits for bad debts taken by Gough for income tax purposes which canceled the remainder of the State Board's initial claim. However, the State Board claimed another $25,263.38 from Gough as of December 1, 1966. This sum included $8,741.78 in interest on the unpaid taxes accruing from September 14, 1964, plus $16,521.60 in penalties. The penalty sum represented $7,923.70 assessed prior to commencement of the Chapter XI proceedings and an additional $8,597.90 assessed on February 4, 1965, for nonpayment of the taxes and prearrangement interest and penalties.

On October 19, 1967, Gough sought an order requiring the Chapter XI estate to pay the accrued interest and penalties and to enjoin the State Board of Equalization from attempting to collect any monies from Gough. After holding an evidentiary hearing, the referee made the following findings of fact:

At the time the court confirmed Gough's plan of arrangement, the receiver did not possess funds sufficient to pay all creditors in full; he did possess enough funds to pay all priority debts in full, including all tax claims with penalties and interest. However, the court did not intend that the order confirming the arrangement would relieve Gough of nondischargeable liabilities or require the receiver to pay any tax liabilities not allowable in straight bankruptcy proceedings. The $86,769.88 in taxes and prebankruptcy interest claimed by the State Board was the only amount properly allowable in bankruptcy.

The referee further found that the receiver paid all tax claims by May 25, 1966: On or about November 10, 1965, the receiver paid certain tax claims totaling $22,398.17; each payment equaled the amount claimed by the taxing authority. On May 25, 1966, he paid the State Board's claim. The receiver had not made an earlier payment to the State Board because he desired to verify the claim and to obtain the credits for bad debts.

From the findings, the referee concluded that the plan of arrangement and the confirmation order did not require the estate to pay the penalties and postarrangement interest. Also, the bad debts were includable in the property of the Chapter XI estate at the time of the arrangement; under the plan, the bad debts passed to the receiver for the creditors' benefit. Thus, the credit of $28,448.43 was an asset of the estate and never revested in Gough. Additionally, the receiver's delay in paying the State Board's claim arose from a reasonable business judgment.

The referee further concluded that the penalties and interest were nondischargeable debts and that the State Board could not properly set off the tax credit against the penalties and interest.

The referee refused to enjoin the State Board's efforts to collect the liabilities assessed against Gough. The bankruptcy court denied Gough's petition for review of the referee's order, and Gough appeals from that order.

Gough argues that three of the referee's adverse findings and conclusions are clearly erroneous: First, Gough says that the referee erred in determining that the estate was not liable for the penalties and interest, based upon its reading of the language of the plan of

arrangement. The "tax claims" which the plan directed the receiver to pay from the deposit are those entitled to priority under section 64(a)(4) of the Bankruptcy Act (11 U.S.C.A. § 104(a)(4). At the time Gough drafted its plan, section 64(a)(4) gave priority to "taxes legally due and owing by the bankrupt to . . . any State or any subdivision thereof. . . ."[2] Because the penalties and interest were due and owing, Gough concludes that they were priority debts that the receiver should have paid from the deposit.

The difficulty with Gough's argument lies in its attempt to number all tax claims among priority debts. The plan defines priority debts as "those which fall under the provisions of Sections 64a(2), (4), and (5) of the Bankruptcy Act." The plan's citation of the Bankruptcy Act strongly suggests that definitions and liabilities commonly imposed by the Act are to control unless explicitly countermanded. If the Act precludes allowance of the disputed tax claims against a debtor's estate, we are constrained to disallow the claims unless the plan provides for them.

Under the Act, the disputed claims are normally not allowable as priority debts. Section 57(j) of the Act (11 U.S.C.A. § 93(j)) precludes allowance of that portion of the penalties incurred by Gough prior

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[2]In 1966, § 64(a)(4) of the Bankruptcy Act was amended to limit priority to taxes "which are not released by a discharge in bankruptcy. . . ." Section 17(a)(1) was also amended to permit discharge of a bankrupt from provable tax claims accruing more than 3 years prior to bankruptcy. Under § 371, a Chapter XI confirmation discharges a debtor from certain debts, but debts not dischargeable under § 17 are excluded. Thus, tax claims arising within the 3-year period are not dischargeable and are entitled to priority.

Here, the State Board claimed taxes owing from April 1, 1962, to September 13, 1964. The claim arose within 3 years preceeding Gough's petition and is not dischargeable.

to the arrangement. (*Boteler v. Ingels* (1939) 308 U.S. 57, 59; *California State Bd. of Equalization v. Goggin* (9th Cir.) 183 F.2d 489, 493, *cert. denied* (1950) 340 U.S. 891; *see World Scope Publishers, Inc. v. United States* (2d Cir. 1965) 348 F.2d 640, 641.) Also precluded is the postpetition interest. (*United States v. General Eng'ring & Mfg. Co.* (1952) 342 U.S. 912, *aff'g* (8th Cir. 1951) 188 F.2d 80; *see Nicholas v. United States* (1966) 384 U.S. 678, 682-91; *New York v. Sapper* (1949) 336 U.S. 328.)

On the other hand, postpetition penalties incurred by the receiver in the operation of the debtor's business are allowable against the estate. (*See Nicholas v. United States, supra,* 384 U.S. at 692-95; *Boteler v. Ingels, supra.*) Gough contends that the receiver's delay in paying the taxes caused the assessment of postpetition interest and penalties. Citing *In re Samuel Chapman, Inc.* (2d Cir.) 394 F.2d 340, *cert. denied sub nom. New York Credit Men's Adjustment Bureau, Inc. v. United States* (1968) 393 U.S. 923, and *In re Chicago & N.W. Ry.* (7th Cir. 1941) 119 F.2d 971, Gough concludes that the estate must be liable for the penalties.

In re Samuel Chapman, Inc., supra, involved the liability of a trustee in bankruptcy for federal income and social security taxes incurred during the operation by the debtor in possession of its business under arrangement proceedings. The Second Circuit reasoned that section 57(j) of the Act proscribing the assessment of penalties against the estate did not apply to postpetition tax claims. The debtor in possession was liable for the penalties, and nothing in section 57(j) required disallowance of the claims against the estate.

In re Chicago & N.W. Ry., supra, involved penalties for failure to pay Illinois taxes. The taxes became a lien prior to institution of proceedings under the Act, but the penalties did not accrue until 14 months after proceedings began. Because the trustee's failure to make timely payment of the taxes caused the penalty accrual, the estate was liable under the rule of *Boteler v. Ingels, supra.*

Neither party has cited or discussed our decision in *California State Bd. of Equalization v. Goggin, supra.* In *Goggin,* the debtor failed to file returns or pay California sales and use taxes prior to its petition under Chapter XI of the Act. California assessed both pre- and postpetition penalties. Under the state law, which has not been amended or repealed, the taxpayer could not avoid the postpetition penalties without paying the prepetition penalty. Because section 57(j) proscribed allowance of the prepetition penalty against the estate, the estate could not pay the first penalty and therefore could not avoid assessment of the subsequent penalties. Section 57(j), therefore, voided all penalties against the estate.

The cases cited by Gough involved postpetition penalties that the estate could have prevented or incurred by its own operation of the debtor's business. Here, however, the receiver could not have prevented accrual of the post-petition penalty, and the postpetition penalties are not allowable unless the plan provides for them.[3]

The plan makes no specific reference to either penalties or interest. Gough contends that the plan's direc-

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[3]A debt is "provided for" by an arrangement if the estate pays the holder of that debt some consideration. (9 W. Collier, *Collier on Bankruptcy* (14th ed. 1969) ¶ 9.32[4], at 934-35.)

tion to the receiver to pay "all tax claims," without any reference to "allowable" tax claims or of any provision for a fund to pay taxes not yet assessed, indicates that the plan required the receiver to pay all tax claims, whether allowable or not, from the deposit. That construction overlooks other portions of the plan. The provision cited by Gough deals with payment of priority claims already defined in terms of the Bankruptcy Act. It does not direct which debts the estate shall assume. The earlier citation of the Act, as contrasted to the order to pay "all" taxes, creates an ambiguity: Either the receiver is to pay all tax claims, or he is to pay priority debts as defined under the Act which excludes the claims in issue. If Gough as draftsman of the plan had intended that the receiver assume liabilities beyond those ordinarily imposed in bankruptcy, the plan could have said so. It does not. We discover no error in the referee's determination construing the ambiguity against the draftsman.

Gough also argues that testimony given by its attorney at the referee's hearing demonstrates that the draftsman intended that the receiver would pay all tax claims, regardless of their nature. The attorney testified that he, the referee, and the receiver conferred over the wording of paragraph 3 of the confirmation order which referred to the revesting of assets in Gough. The paragraph originally stated that the assets would revest "free and clear of any claims, liens or liabilities whatsoever. . . ." The referee suggested inserting the phrase "which are dischargeable" after the word "whatsoever." When Gough's attorney asked the referee what he had in mind, the referee replied that "he did not feel that the creditors should hold the debtor harmless from any claims that might have arisen through fraudu-

lent conduct and matters of that kind." The referee testified that he had no independent recollection of this conversation.

From this testimony, Gough argues that the confirmation order contemplated revesting assets in Gough free of all claims except those made nondischargeable by reason of fraud. The estate would pay all other nondischargeable claims. It says the State Board must proceed against the estate rather than against Gough.

Gough's attempt to limit its liability to debts obtained by fraudulent means is not persuasive. Section 371 of the Act (11 U.S.C.A. § 771) provides that the confirmation order

> "shall discharge a debtor from all his unsecured debts and liabilities provided for by the arrangement, . . . but excluding such debts as, under section 17 of this Act, are not dischargeable."

Section 17 (11 U.S.C.A. § 35) numbers among nondischargeable debts both debts obtained by fraud and "taxes which became legally due and owing by the bankrupt to . . . any State. . . ."[4] Because the plan did not expressly provide for the payment of penalties and interest, those debts are no more dischargeable than are claims based on fraud. The insertion of the phrase "which are dischargeable" specifically subjects the revested assets to all nondischargeable debts, including the tax claims.

Alternatively, Gough argues that the estate should have paid the penalties and interest as an expense of administration. At the time Gough drafted its plan, section 337(2) of the Act (11 U.S.C.A. § 737(2), as

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[4]See note 2 *supra*.

amended (Supp. 1970), provided for payment of two substantially similar types of administrative expenses. First, the section required the debtor to deposit "the money necessary to pay all debts which have priority. . . ." Second, the section required the debtor to deposit

> "the money necessary to pay the costs and expenses of the proceedings and the actual and necessary expenses incurred in connection with the proceedings and the arrangement . . . in such amount as the court may allow. . . ."

Section 64a(1) places among priority debts the costs of administering and preserving the estate. The expenses necessary to preserve the estate may include taxes accruing during the course of administration.[5] (*See* 3A W. Collier, *Collier on Bankruptcy* (14th ed. 1969) ¶ 62.14[3], at 1529-33 & nn. 82, 86.) If the draftsman had modeled the plan's provision for payment of administrative expenses upon the Act's provision relating to priority debts, it could be argued that the plan subsumed tax claims within expenses of administration. But the plan's language indicates that the draftsman based the definition of administrative expenses upon the second reference appearing in section 337(2).

Rather than citing section 64a(1) in the definitions of either priority debts or expenses of administration, the draftsman pointedly omitted section 64(a)(1) while defining expenses of administration as "those expenses

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[5]Since the plan did not provide for the penalties and interest, liability lay with the debtor. The receiver did not have to pay these claims to preserve the estate. Furthermore, taxes qualifying as expenses of administration are normally those incurred after the petition is filed. (*See Nicholas v. United States, supra,* 384 U.S. at 687-88.) Here, the tax accrued prior to filing the petition.

commonly known as Court expenses of administration incurred herein which may be approved, allowed or ordered paid by the Court." The reference to allowance by the court conforms to the wording of section 337-(2). Further, the plan's provision for payment of creditors also demonstrates that the draftsman intended to treat tax claims as priority debts rather than as expenses of administration. The payment provision enumerates typical costs of administration such as "the Referee's Salary and Expense Fund, Court Reporter, Appraisers, Controller, and sums to be paid to the attorneys. . . ." The expenses included under section 337(2) as costs of the proceedings generally comprise the compensation of court officers and their employees and the costs they incur during administration. (8 *Collier on Bankruptcy, supra* § 5.34[1], [2].) Taxes are not included. The plan's examples are consistent with the costs ordinarily subsumed under the costs of the proceedings provision of section 337(2). On the other hand, the plan specifically directs payment of tax claims as priority debts. From the language and structure of the plan, we conclude that the tax claims were not included among expenses of administration.

Second, Gough contends that the referee erred by ruling that the postpetition tax credits were not an asset of Gough. In 1965, Gough decided that certain prepetition accounts receivable were not collectible and wrote them off as bad debts for income tax purposes. In 1966, California recognized the uncollectibility of the receivables and reduced the corresponding sales and use taxes then due. Both parties have framed their arguments in terms of the transferability of the credits. We believe that our decision should rest on the transferability of the accounts receivable.

Section 70a of the Act (11 U.S.C.A. § 110a) governs the transferability of a bankrupt's assets. In a Chapter XI proceeding, section 70a determines the property of the estate that the receiver will administer. (8 *Collier on Bankruptcy, supra* ¶ 6.16[3].) Included among the items comprising the estate are "property, including rights of action, which prior to the filing of the petition he [the debtor] could by any means have transferred" and "rights of action arising upon contracts." (Bankruptcy Act §§ 70a(5) and (6).)

In *Segal v. Rochelle* (1966) 382 U.S. 375, the bankrupts suffered losses in the year of bankruptcy. The losses were carried back to previous years to offset bankrupt's federal income tax. The issue was whether the trustee or the bankrupts were entitled to the loss-carryback tax refunds. In holding that the refunds attributable to prebankruptcy losses constituted "property" at the time the bankruptcy petitions were filed, the Court reasoned that

> "[t]he main thrust of §70a(5) is to secure for creditors everything of value the bankrupt may possess in alienable . . . form when he files his petition. . . . Turning to the loss-carryback refund claim in this case, we believe it is sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupts' ability to make an unencumbered fresh start that it should be regarded as 'property' under § 70a(5)." (382 U.S. at 379-80.)

The Court held that the refunds were transferable under the relevant state law, and, therefore, the trustee acquired title to the refunds under section 70a(5) of the Act. The Court declined to consider the transfer

of loss-carryovers, but it recognized that these were conceptually and practically distinguishable from loss-carrybacks.

Gough argues that if *Segal* controls, the tax credits are analogous to a carryover. Gough appears to reason that the sales were a past event that gave rise to a present tax credit for the bad debts just as a prior loss creates a present credit for the carryover. We do not agree that the credits are like a carryover, either conceptually or equitably. The difficulty with the analogy lies in determining which event gives rise to the credits. For example, if the estate had no income in the year the debts were written off (the present event), the write-off would create a loss that could be applied against past income just as in the case of a carryback. Although the sale is the initial taxable event, the write-off creates the credits. Because the present write-off generates the tax credits, this situation is equally analogous to a carryback. Equitably, however, the credits are substantially closer to a carryback. A carryover cannot exist until the present loss has been applied against past income. If there is any prebankruptcy income, the creditors obtain the refund's benefits before the remaining loss is applied to future income. But if the credits are treated as carryover and used to reduce Gough's future taxes, the creditors would be deprived of both the asset which Gough sold and the credit against the tax generated by the sale. That result is particularly unfair because the improvident sales may well have contributed to Gough's financial failure. (*See* 4A *Collier on Bankruptcy, supra* ¶ 70.28[4], at 404.)

Gough's primary argument is that *Segal* does not control. We agree that *Segal* is not controlling, but for

different reasons than those advanced by Gough. In *Segal,* the dispute was over funds that the bankrupts had originally paid to the Government. Their claim to those funds raised an equitable issue. But in our case the dispute involves a reduction of taxes owed by the estate. The accounts receivable generated the sales and use taxes owed by Gough. According to the plan of arrangement, these receivables passed to the estate. Confirmation of the arrangement vested title to the accounts in the receiver. (*See Bankruptcy Act* § 70i.) The estate became liable for the corresponding taxes. When the receivables were written off as bad debts, the amount of the tax became excessive. The excess was to be credited "on any amounts then due and payable *from the person from whom the excess amount was collected or by whom it was paid. . . .*" (Cal. Rev. & Tax. Code § 6901. Emphasis added.) Because the estate and not Gough was to pay the tax, state law required crediting the excess against the taxes due and payable from the estate. The estate owed the tax, and under California law it was entitled to the credit; Gough incurred the tax, but it was absolved of liability by the arrangement. Because the funds comprising the credits came from the estate, equitable considerations differ substantially from those encountered in the loss-carryback situation where the bankrupt has provided the funds that make up the refund.

The crux of Gough's argument is that the credits are after-acquired property which could not pass to the receiver. Although it is true that property acquired by the debtor after confirmation of the plan does not ordinarily become a part of the estate (9 H. Remington, *A Treatise on the Bankruptcy Law of the United States* § 3644, at 304; *see* 4A *Collier on Bankruptcy,*

supra ¶ 70.09, at 103-05), the credits are not strictly property acquired by the debtor subsequent to the confirmation. Rather, the estate as owner of the receivables acquired the credits. Proceeds of alienable property owned by the debtor at the time the petition is filed vest in the receiver. (*See id.* at 106 & n. 7.) We see no meaningful distinction between proceeds such as dividends from stock vested in the estate and the tax credits resulting from the write-off of receivables owned by the estate. Gough concedes that the accounts were correctly transferred to the estate. The credits from these accounts were never acquired by Gough and cannot be used to offset its taxes.

Third, Gough contends that the referee erred in finding that the receiver's delay in paying the state tax was justifiable. The referee found that the receiver delayed payment because he wanted to verify the tax and to obtain the bad debt credits. Gough cites the receiver's testimony that he withheld payment in order to obtain credits for uncompleted sales and sales directly by the manufacturer to the customer which had been charged to Gough, to fix an undisputed amount of the tax due less penalties and interest, and to determine whether the state would tax the estate's liquidation sales. It points out that the receiver delayed 11 months from the date of confirmation of the plan before paying two other undisputed tax claims although the monies deposited by Gough were sufficient to pay all taxes, together with penalties and interest. This delay, Gough asserts, demonstrates dilatory payment of all tax claims.

The receiver was not liable for prepetition penalties. The postpetition penalty was assessed less than one month after the state filed its claim. The accrual of

this penalty cannot be attributed to dilatory acts by the receiver. Under *Goggin, supra,* the receiver could not legally have prevented the assessment. However, the postpetition interest presents different considerations.

Taxes are not accorded a greater priority than other priority debts. Indeed, under section 64(a), they are to receive fourth priority. The estate cannot be charged with postpetition interest simply because the receiver did not accord the tax claims first priority. (*United States v. Kalishman* (8th Cir. 1965) 346 F.2d 514, 520, *aff'd sub nom. Nicholas v. United States* (1966) 384 U.S. 678, 687-88.) As the Supreme Court noted in *Nicholas v. United States, supra* at 683-84:

> "[C]reditors should not be disadvantaged *vis-a-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws. In the context of interest-bearing debts, . . . inequity . . . would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing relatively high rates of interest were permitted to absorb the assets of a bankrupt estate whose funds were already inadequate to pay the principal of the debts owed by the estate."

The record does not clearly indicate that the receiver's delay was due to factors other than those inherent in bankruptcy proceedings. It also fails to disclose whether the receiver gave undue priority to claims other than the taxes. On the basis of this record, we cannot say that the referee's finding was clearly erroneous.

AFFIRMED.